VZCZCXYZ0000
PP RUEHWEB

DE RUEHDG #3308/01 2961134
ZNR UUUUU ZZH
P 231134Z OCT 06
FM AMEMBASSY SANTO DOMINGO
TO RUEHC/SECSTATE WASHDC PRIORITY 6462
INFO RUEHZA/WHA CENTRAL AMERICAN COLLECTIVE PRIORITY
RUEHWN/AMEMBASSY BRIDGETOWN PRIORITY 1980
RUEHCV/AMEMBASSY CARACAS PRIORITY 0682
RUEHGE/AMEMBASSY GEORGETOWN PRIORITY 0906
RUEHKG/AMEMBASSY KINGSTON PRIORITY 2657
RUEHPO/AMEMBASSY PARAMARIBO PRIORITY 1040
RUEHPU/AMEMBASSY PORT AU PRINCE PRIORITY 4372
RUEHSP/AMEMBASSY PORT OF SPAIN PRIORITY 1728
RHEHNSC/NSC WASHDC PRIORITY
RUEAIIA/CIA WASHINGTON DC PRIORITY
RHEFDIA/DIA WASHDC PRIORITY
RUEHC/DEPT OF LABOR WASHDC PRIORITY
RUEATRS/DEPT OF TREASURY WASHDC PRIORITY
RUCPDOC/USDOC WASHDC PRIORITY 1578

UNCLAS SANTO DOMINGO 003308

SIPDIS

SIPDIS

DEPT FOR WHA, WHA/CAR, WHA/AND, INR, EB/ESC/IEC/EPC;
TREASURY FOR OASIA-JLEVINE; DEPT PASS USDA FOR FAS; USDOC
FOR 4322/ITA/MAC/WH/CARIBBEAN BASIN DIVISION
USDOC FOR 3134/ITA/USFCS/RD/WH

E.O. 12958: N/A
TAGS: EFIN ETRD DR
SUBJECT: DOMINICAN PLAN TO RECAPITALIZE CENTRAL BANK SEEN
AS CRITICAL TO IMF PROGRAM

1.(U) In its April 2006 Letter of Intent to the IMF, the Dominican government committed to formulate by July a plan to recapitalize the Central Bank as part of its structural reform agenda. The need stems from the overhang of quasi-fiscal debt issued and managed by the Central Bank in order to cover the hasty government guarantee of the equivalent of nearly US$3 billion in deposits lost in a series of bank frauds that came to light in 2003. The recapitalization plan was originally to have been completed by March but was delayed, according to the letter, to allow the government time to "incorporate the recommendations of international experts." The subsequent July deadline was also missed. On August 31, Central Bank Governor Hector Valdez Albizu announced that the Bank would use a ten year Treasury bond to recapitalize itself and to "cover all of its losses since it was established in 1947."

2.(U) When the Fernandez government took office on August 16, 2004, the Central Bank stock of CDs (called "Valores en Circulacion" in CB statements)to bailout the 2003 bank failures was 94.8 billion Dominican Pesos. As of August 31, ¶2004. By Oct-09 of this year the figure had risen to 157.4 billion Dominican Pesos. Compared with the extremely short term debt issued in the early days following the bank crisis (with maturities of as little as one week), maturities have been stretched to three years and interest rates have been reduced from over 50 percent to an average of 11 percent today. The monthly cost of servicing the outstanding stock of certificates has fallen from 3.4 billion pesos (about 4 percent of GDP) per month to 2 billon pesos (less than 3 percent of GDP).

3.(U) Albizu's announcement of the Bank's plan was met with criticism primarily due to the lack of details regarding how it would work. Albizu had referred to the issuance of a bond, but no terms or other information was given. In early September Central Bank General Manager Pedro Silverio confirmed that a government bond would be used to

recapitalize the bank and said that under no circumstances would any funds associated with the bond be substituted for those in the CDs, which would continue to be honored.

4.(SBU) The IMF Resrep told economic officer in September that the IMF had worked with the Dominicans to develop this recapitalization proposal. He said the plan calls for the Ministry of Finance to place a series of bonds in the Central Bank over a period of 10 years. The bonds are unusual in that they are not being sold publicly. The central government will create the bonds as an accounting tool that will serve as an asset to offset the Central Bank's debt and, thereby, transfer that debt to the Ministry of Finance. Interest earned will be used by the Bank to cover interest payments on its stock of outstanding CDs. The Resrep said that this strategy is not uncommon and has been used successfullly in other countries where the IMF has programs.

5.(SBU) Central Bank Deputy Technical Manager Rolando Reyes told economic officer on October 13 that the bonds to be deposited in the Central Bank would be keyed to match the interest rates of the outstanding CDs. As existing CDs come due, the Central Bank will continue to issue new CDs to payoff the old debt, and new bonds will be issued by the Finance Ministry and transferred to the Central Bank periodically to cover the new debt. What has apparently not yet been decided is how the Central Bank and central government plan to stop the cycle of issuing new public debt to pay off the outstanding interest and principal, something that must happen to eliminate the debt once and for all.

6.(SBU) Reyes commented that the public has misunderstood the Central Bank's plan because the concept of the government (Treasury) issuing a bond that is not sold in the market is

not common. He said the plan is critical for the government to comply with its IMF obligations and added that the Central Bank wants to see the IMF standby agreement extended beyond the current March 2007 end date. Comment: Another reason why the plan has been misunderstood--by both the general public and by economists--is that the Central Bank has not made details widely known. In public statements by Silverio and other Central bank officials, the concept of a bond that is issued and bought by the same central government has not been discussed. The plan has merit. Unlike a line item in the annual budget that could be used to achieve the same transfer of funds from the central government to the Central Bank, the bond is a promise to pay that will be more difficult to erase under a new presidential administration than would be a budget line item. End comment.

HERTELL